

# Peer Analysis and Balance Sheet Strategies Update



August 15, 2024

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# Presenters



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Vice President, Director of Member Strategies + Solutions



**Derek Hamilton**

Senior Financial Strategist

# Overview

- Markets & Economy Update
- Peer Analysis & Call Report Trends
- Balance Sheet Strategies

## Poll Question

The Federal Funds Target Range is currently 5.25% to 5.50%. Three Fed meetings are left in 2024 - September, November and December.

**How many rate cuts (in 25 basis point increments- i.e., a 0.50% cut counts as two cuts) do you believe will happen in 2024?**

- A:** zero to one cut (Lower limit of 5.00% or higher)
- B:** two to three cuts (Range between 4.50% to 5.00%)
- C:** four to five cuts (Range between 4.00% to 4.50%)
- D:** six or more cuts (Upper limit of 4.00% or lower)

# Poll Result Analysis

What rate path are members rooting for?



# Markets & Economy Update

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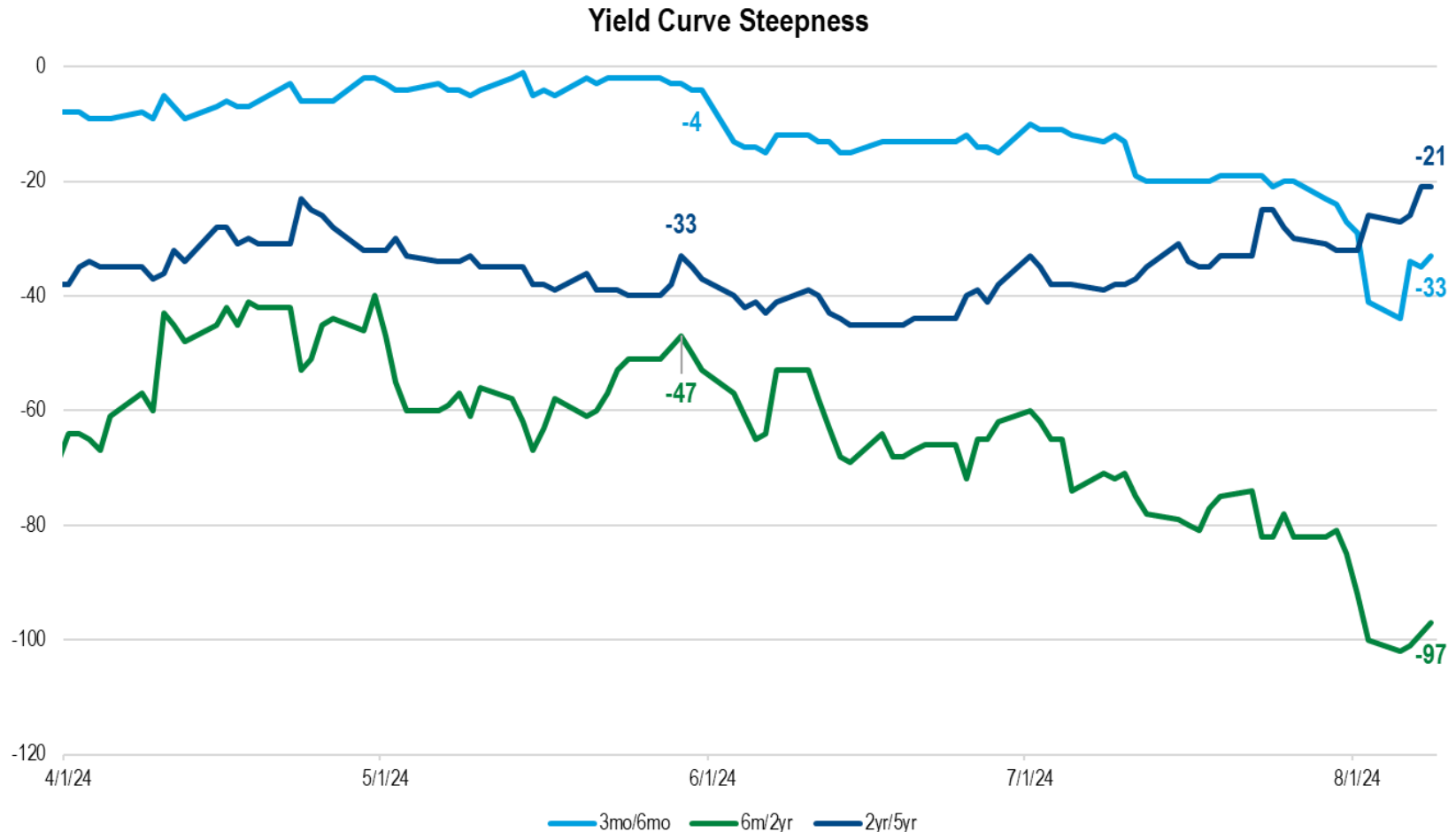
# Markets & Economy Update

- Yield Curve Shifts
- Mortgages & Credit Spreads
- Inflation & Unemployment
- Health of the Consumer



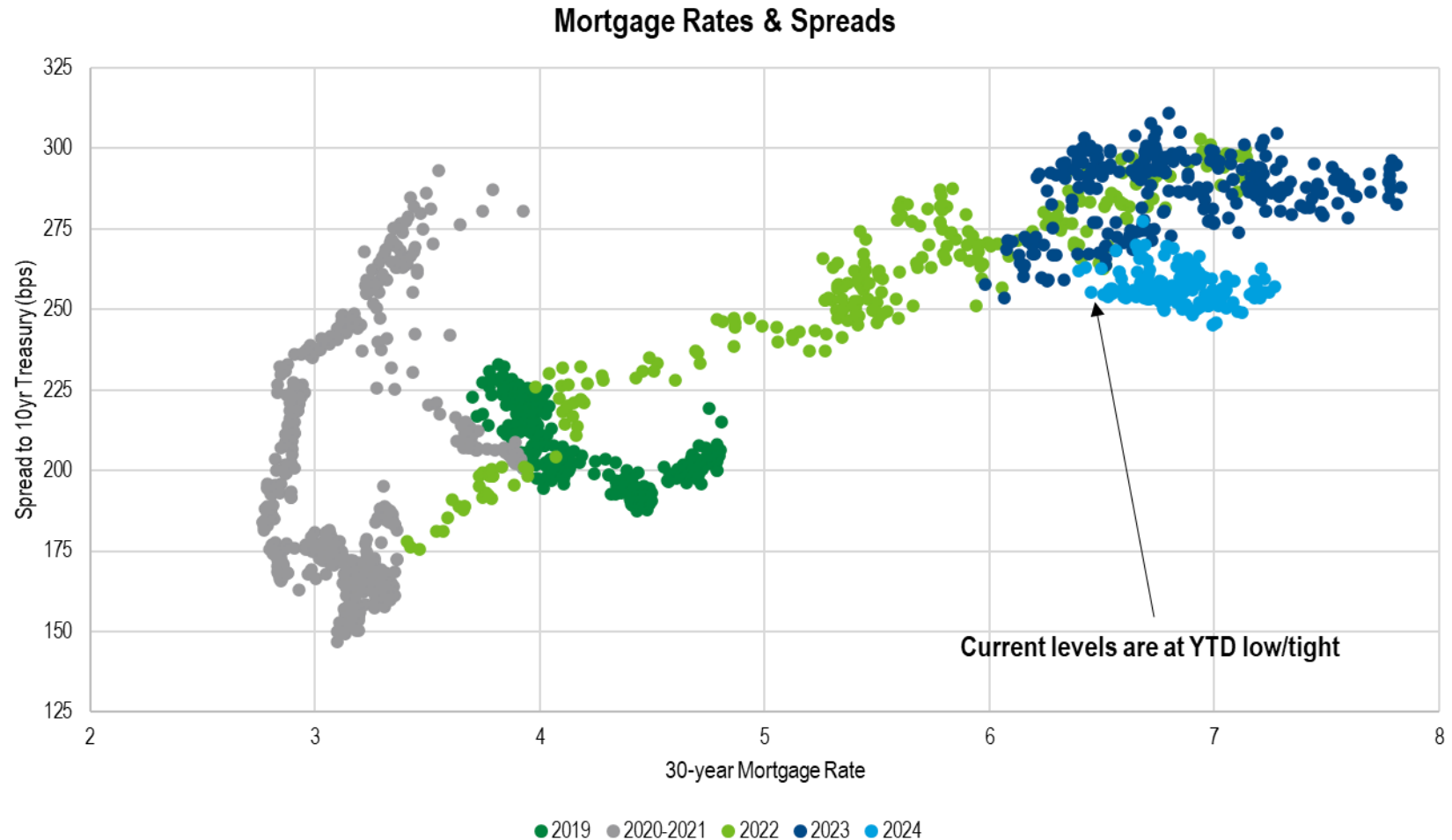
# Yield Curve Gyration

In the last two months, sentiment has shifted as the market has advanced rate cut expectations.



# Lower Mortgage Rates & Narrowing Spreads

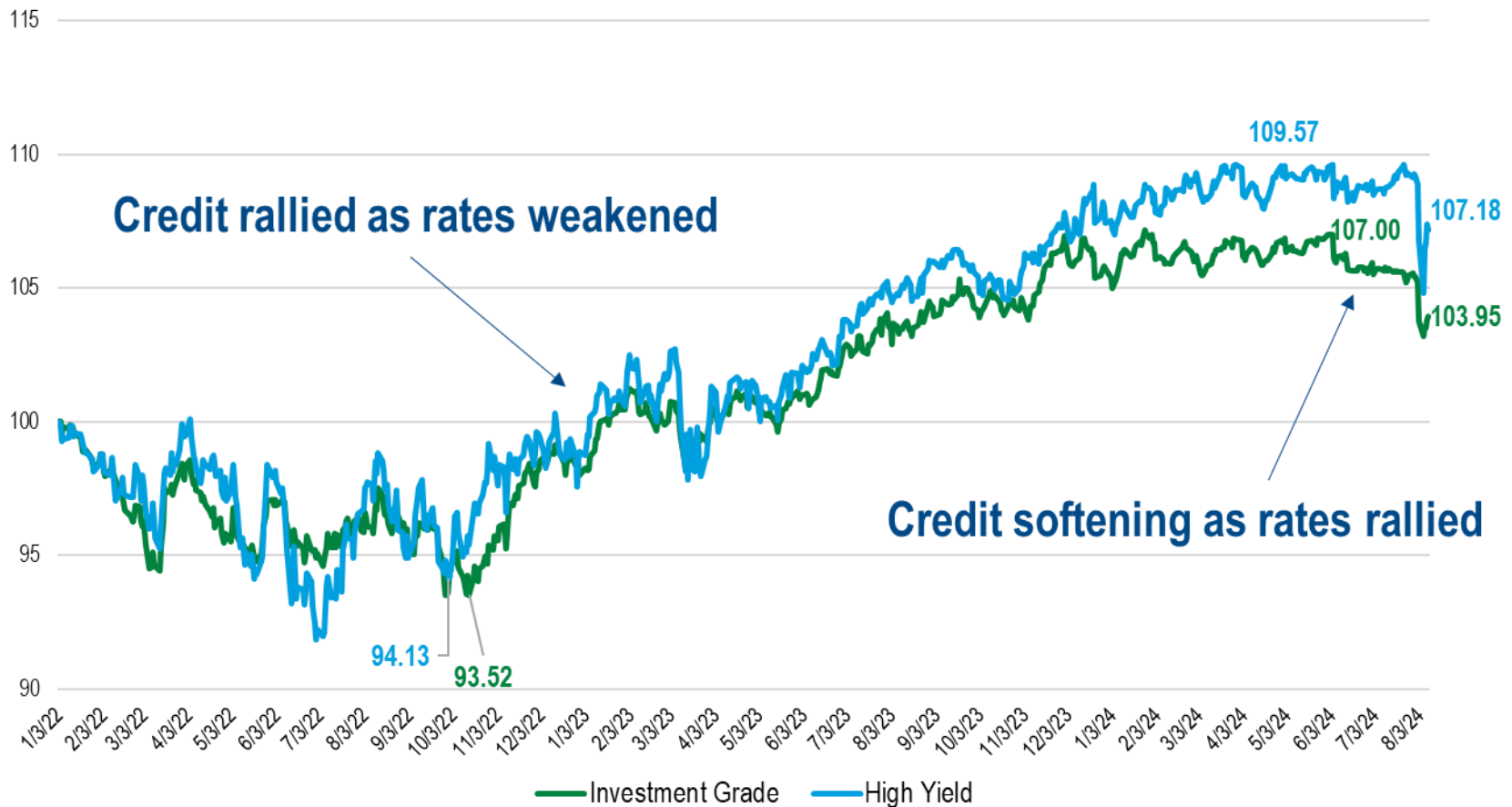
Mortgage rates have come down, and spreads have tightened from historically high and wide levels.



# Credit Spreads

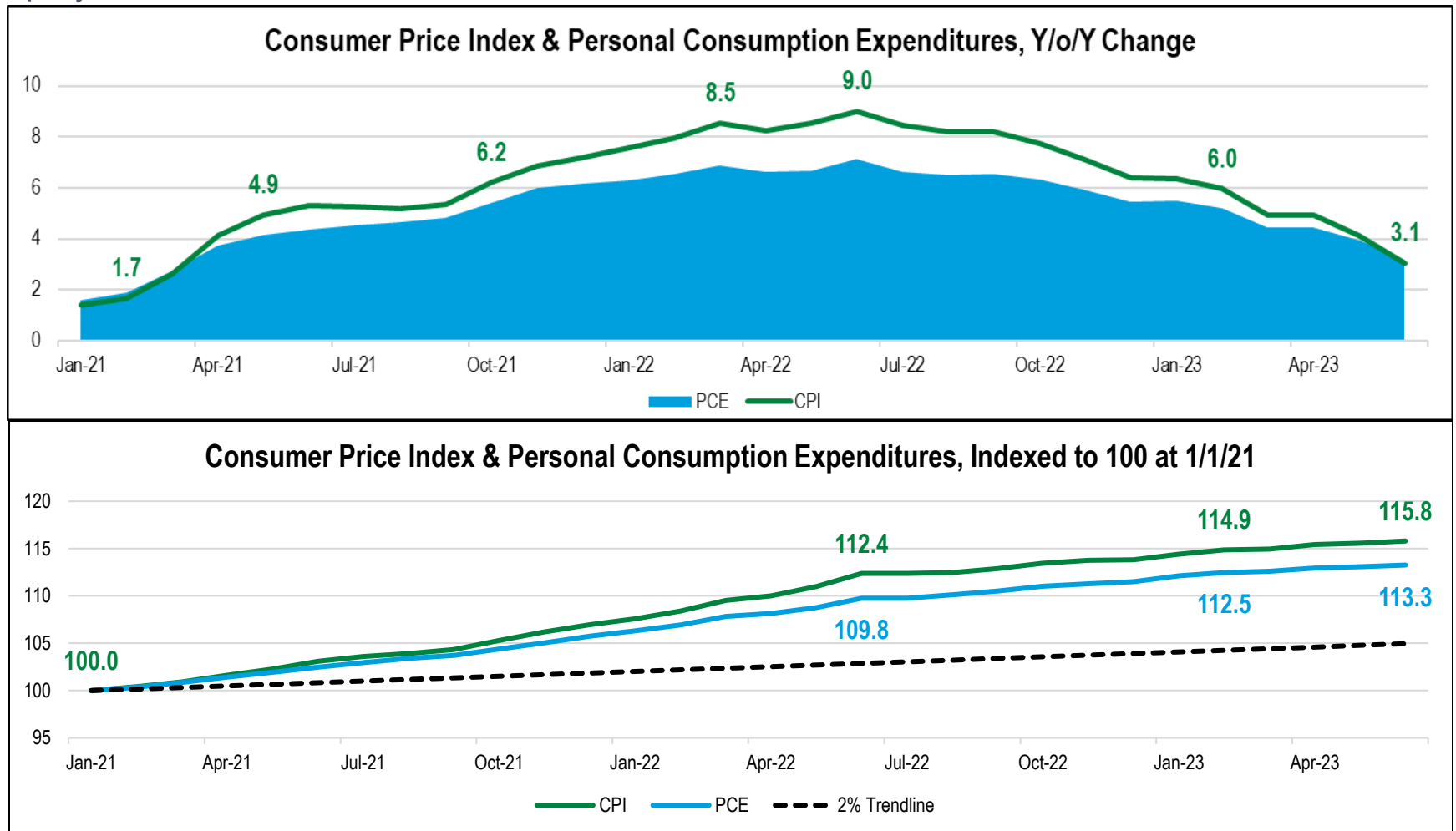
In a reversal from 2023, credit spreads have widened as rates moved lower.

Interest-Rate Hedged Corporate Bond ETF Performance:  
Price Indexed to 100 at 1/1/2022



# Inflation

Headline readings continue to improve, but the compounding effect is still very much in play.

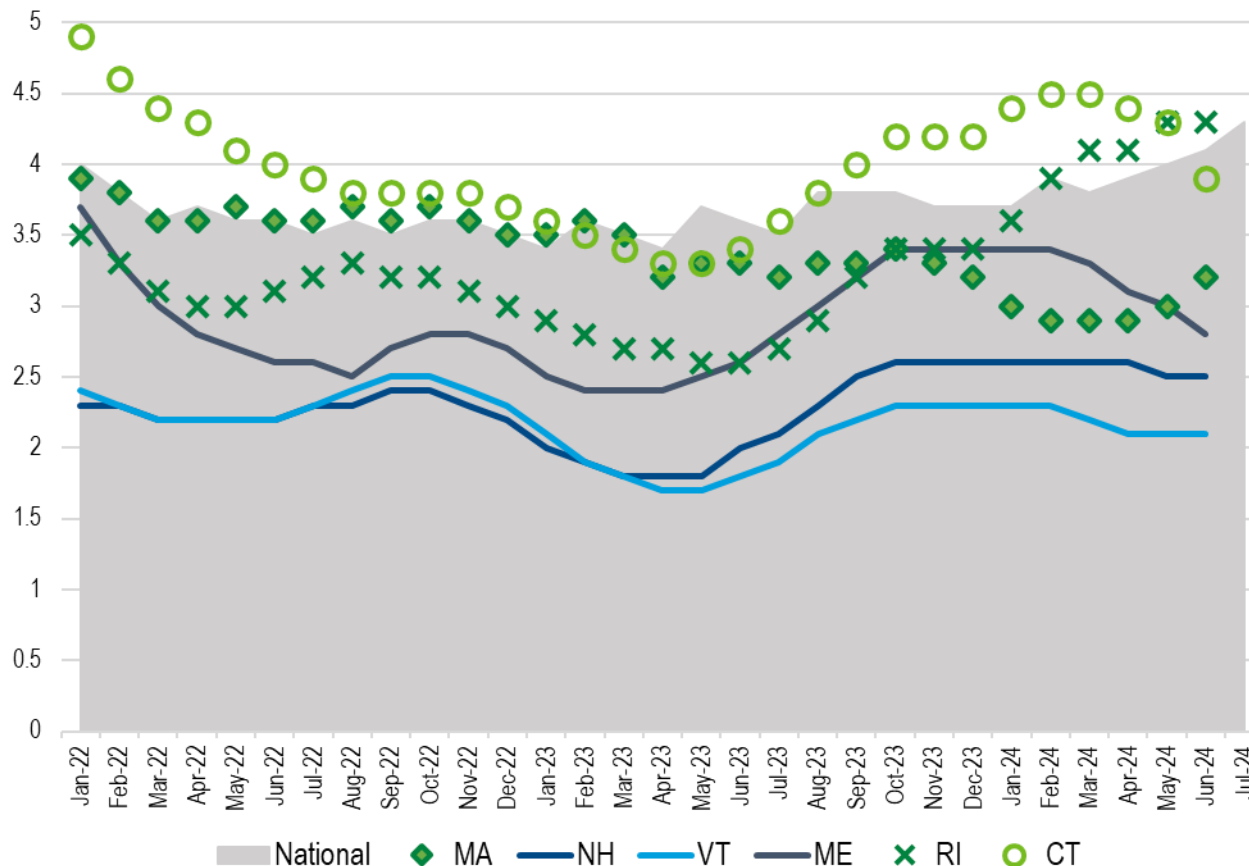


Source: Federal Reserve Bank of St. Louis, FHLBank Boston

# Unemployment

On the national level, unemployment is starting to tick up, but New England continues to outperform national.

Unemployment Rate: National & New England States



Change in U/E rate from the low & when the low occurred

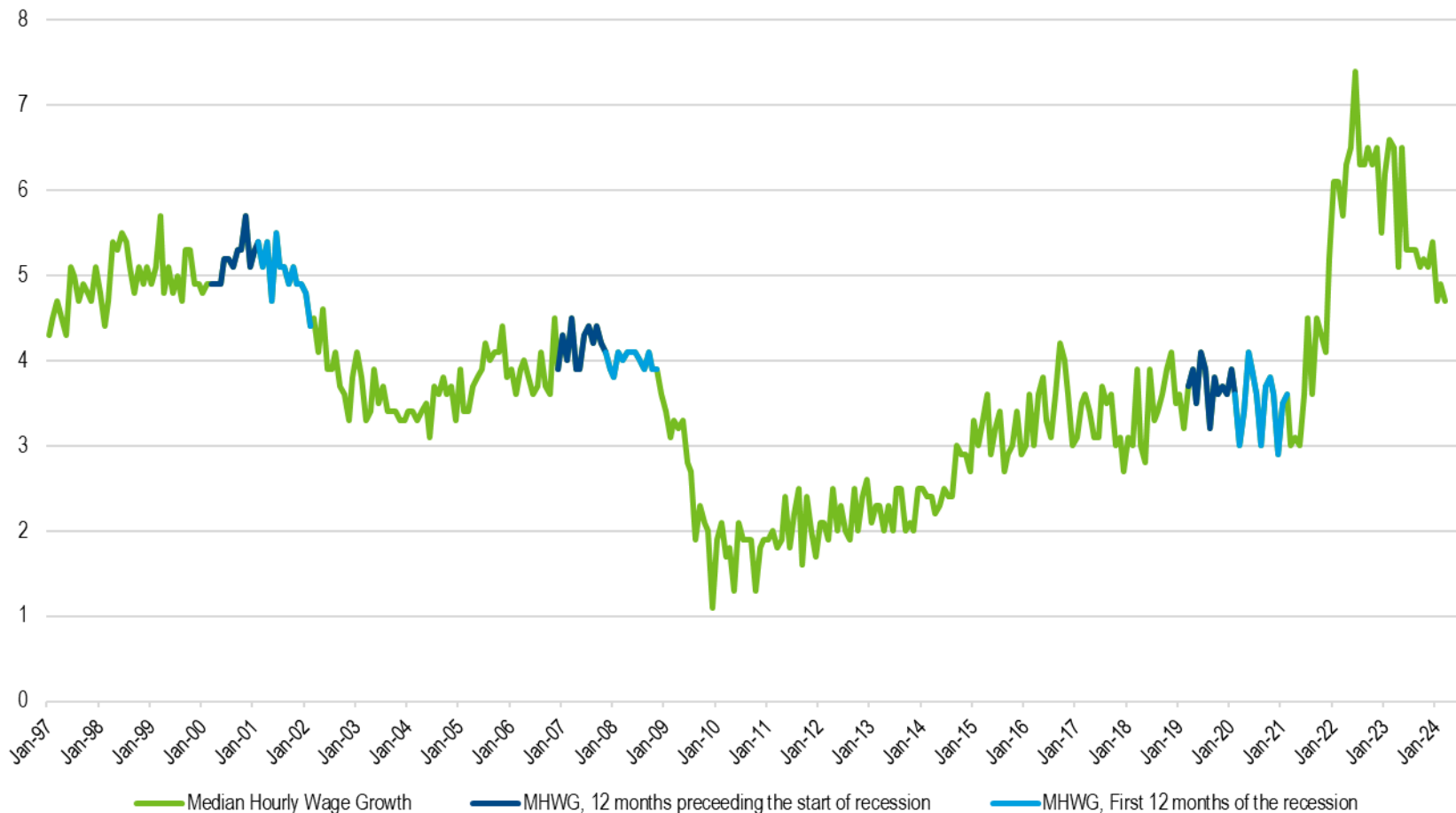
National	+0.9%	April 2023
MA	+0.3%	April 2024
CT	+0.6%	May 2023
RI	+1.7%	June 2023
VT	+0.4%	May 2023
NH	+0.7%	May 2023
ME	+0.4%	April 2023

Source: Federal Reserve Bank of St. Louis, FHLBank Boston

# Consumer Wealth Effect

An odd dynamic is at play, as wage growth is still historically strong yet is trending down.

Median Hourly Wage Growth



Source: Federal Reserve Bank of Atlanta, FHLBank Boston

# Peer Analysis & Call Report Trends



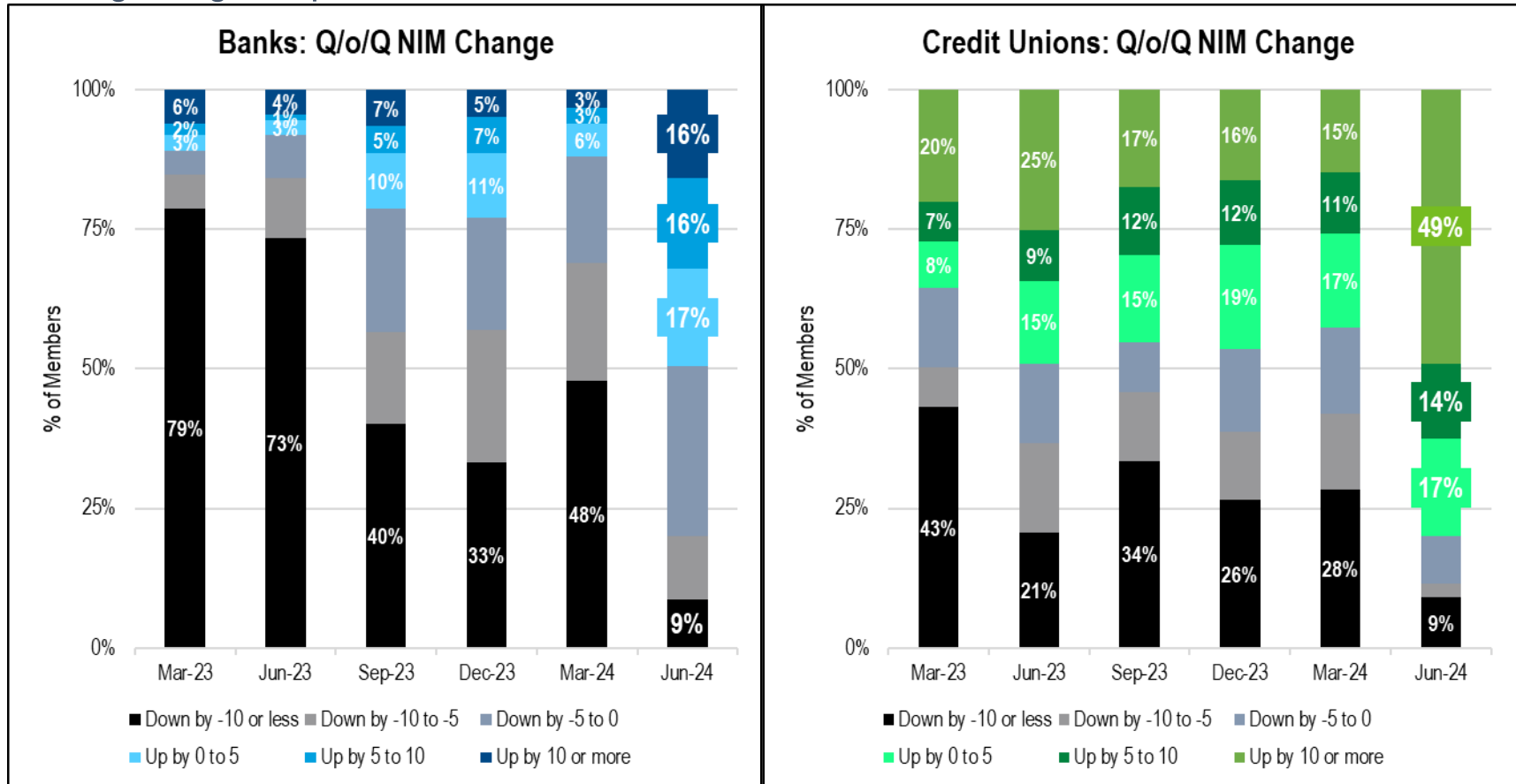
# Peer Analysis & Call Report Trends

- Margin Trends
- Drivers of Interest Expense
- Loan Mix Shifts
- Growth
- Investment Portfolio Changes
- Deposit Composition
- Credit



# Net Interest Margin Stabilizing?

Positive trends in the second quarter with nearly half of banks and 80% of credit unions seeing margin expansion.

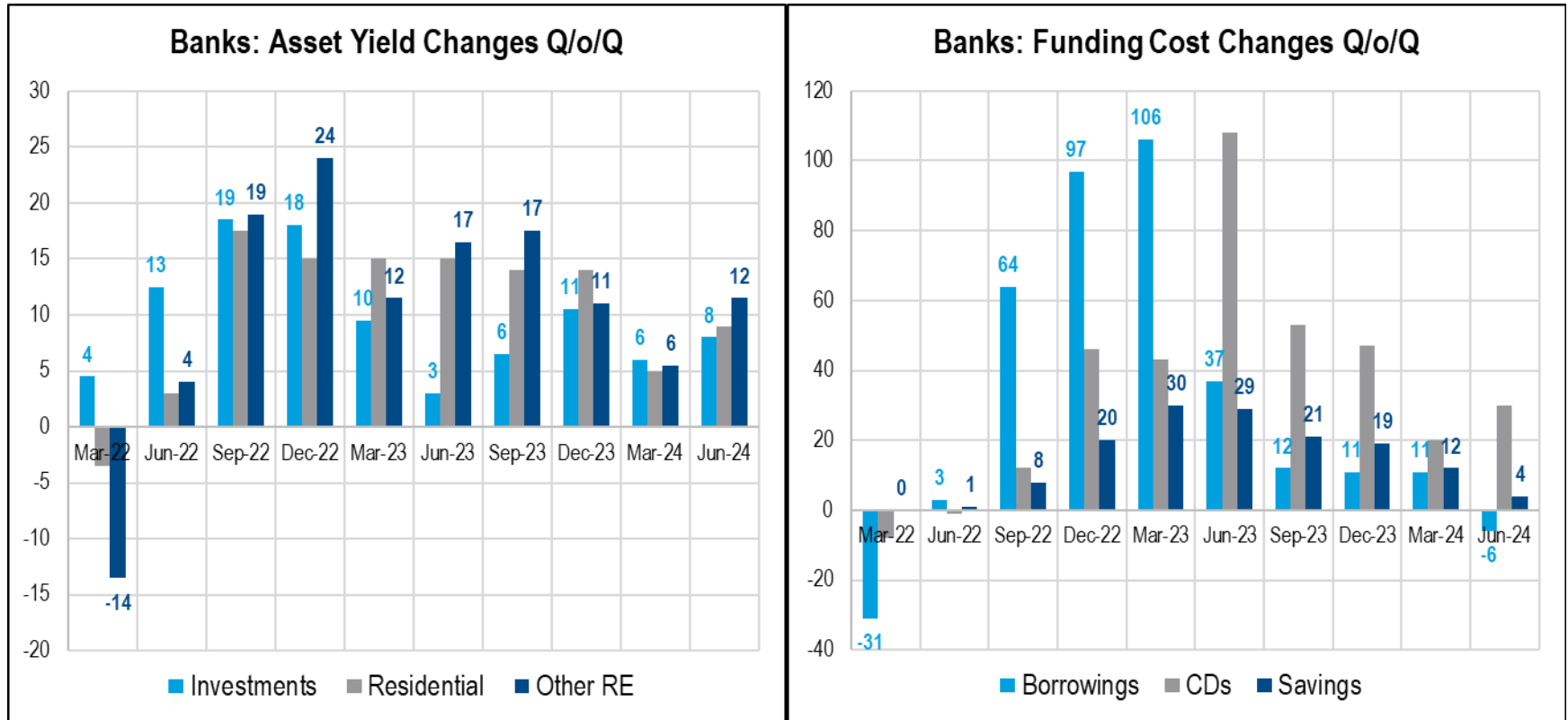


**Median NIM: 2.56%**

**Median NIM: 3.28%**

# Banks: Margin Support

The magnitude of asset yield improvements ticked up, while changes in funding costs continued to moderate.

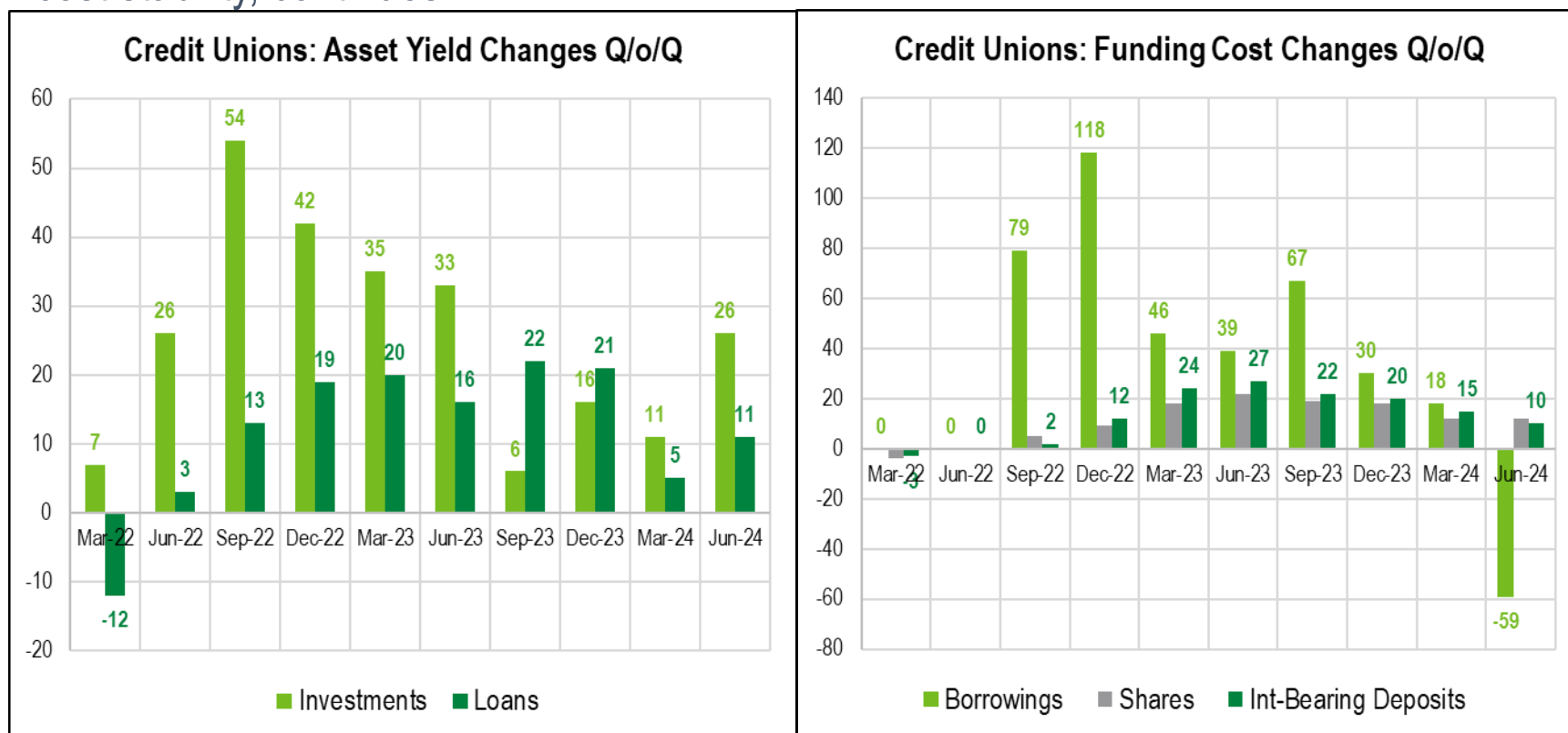


## Median Yield/Cost at 6/30/24

Investments	Residential	Other Real Estate	Borrowings	CDs	Savings
2.73%	4.58%	5.43%	4.31%	4.18%	1.61%

# Credit Unions: Margin Lift

The trend of relatively rapid loan and investment yield repricing, as well as deposit cost stability, continues.

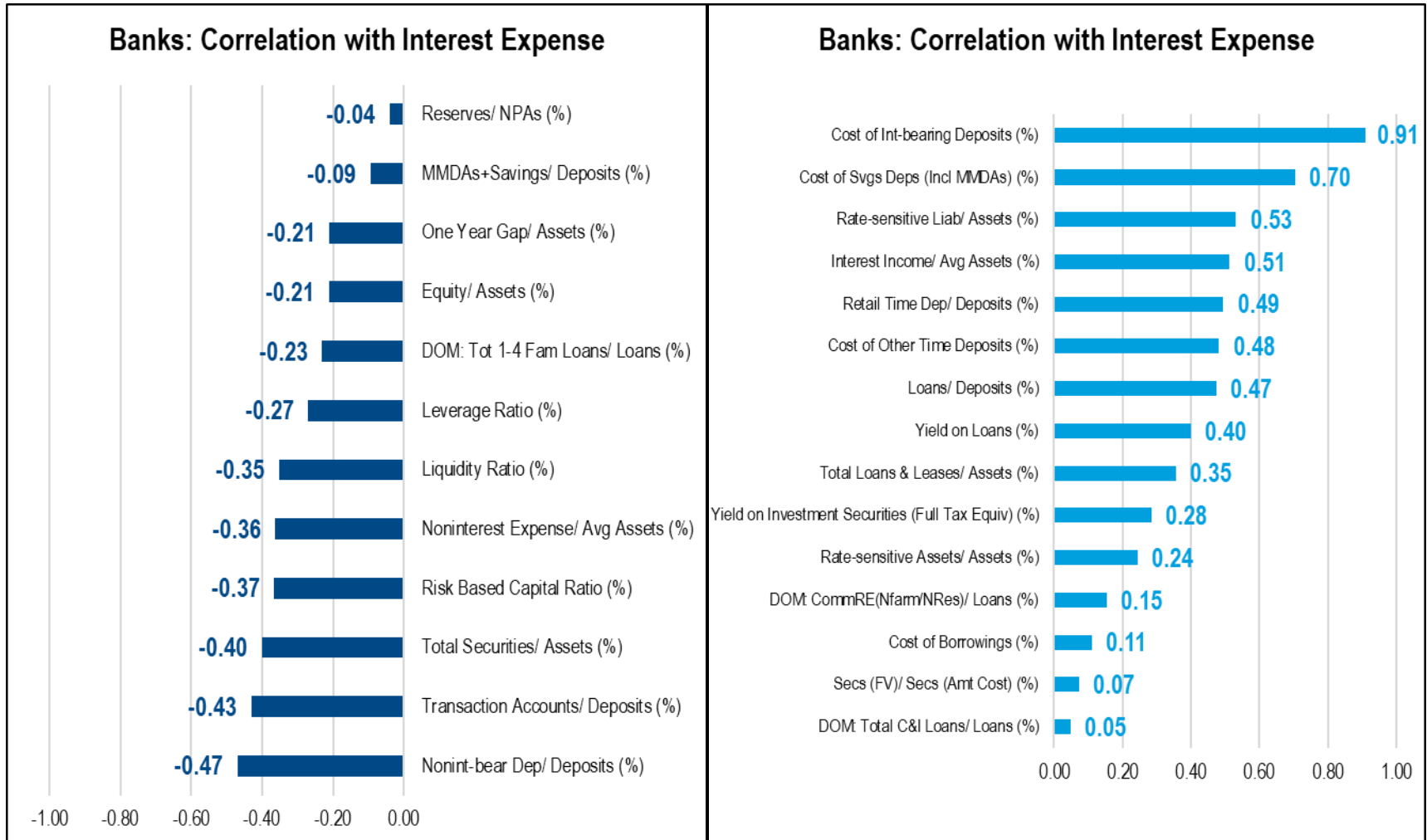


Median Yield/Cost as of 6/30/24

Investments	Loans	Borrowings	Shares	Int-Bearing Deposits
3.27%	5.23%	3.38%	1.37%	1.59%

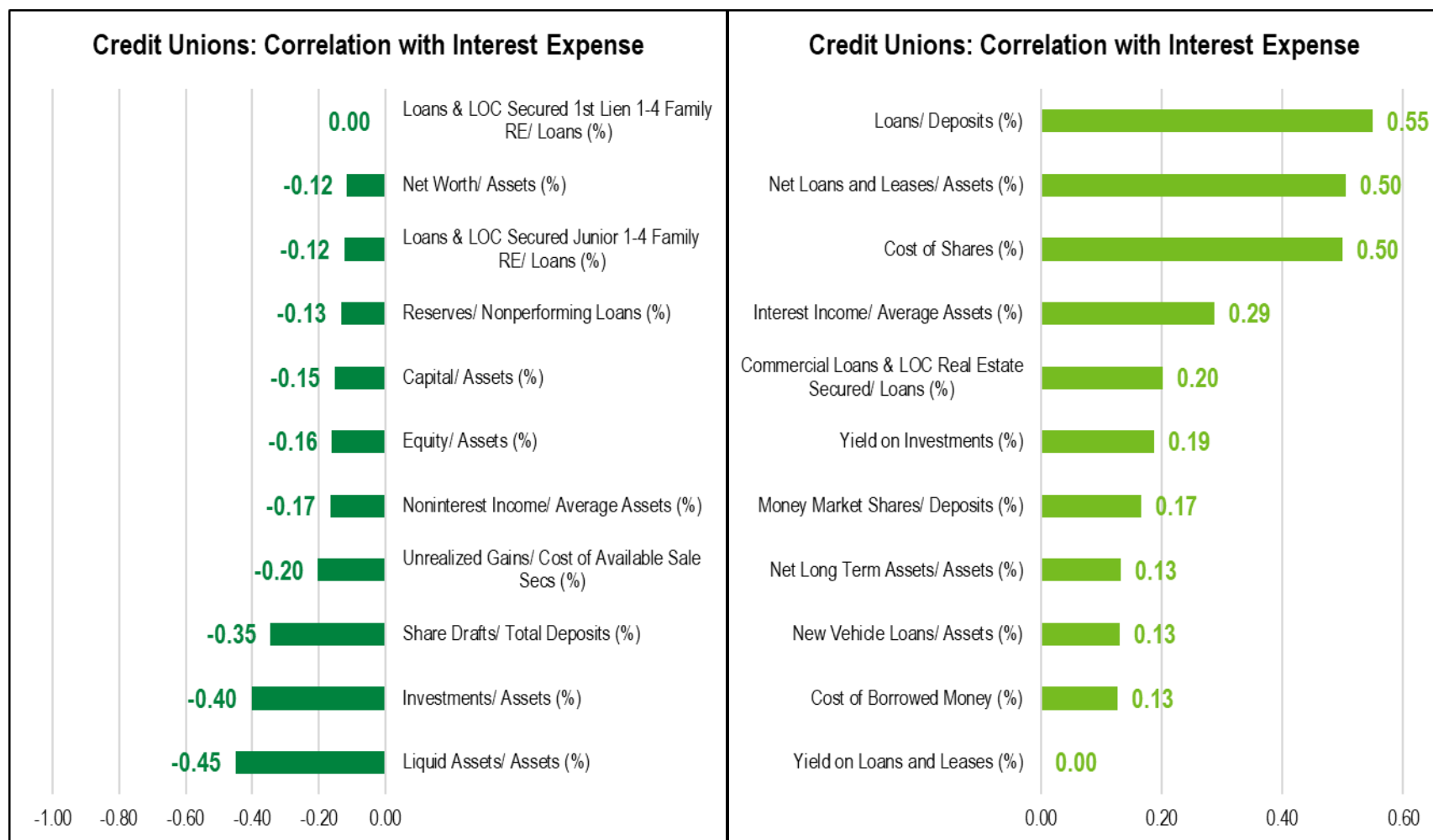
# Banks: What Drives Interest Expense?

Interesting relationships exist between those with higher interest expense and various balance sheet and income statement characteristics.



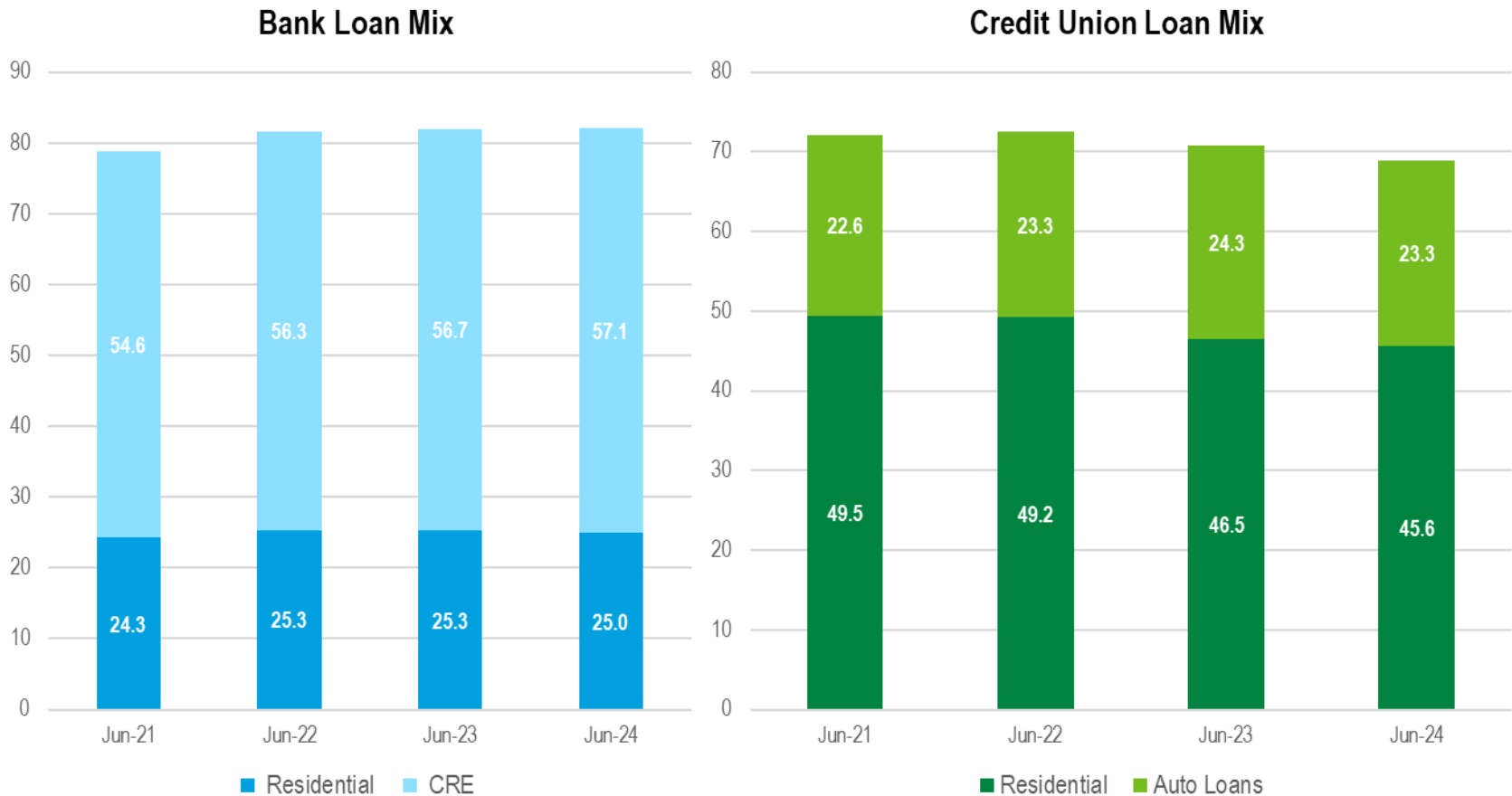
# Credit Unions: What Drives Interest Expense?

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# Loan Mix Evolving

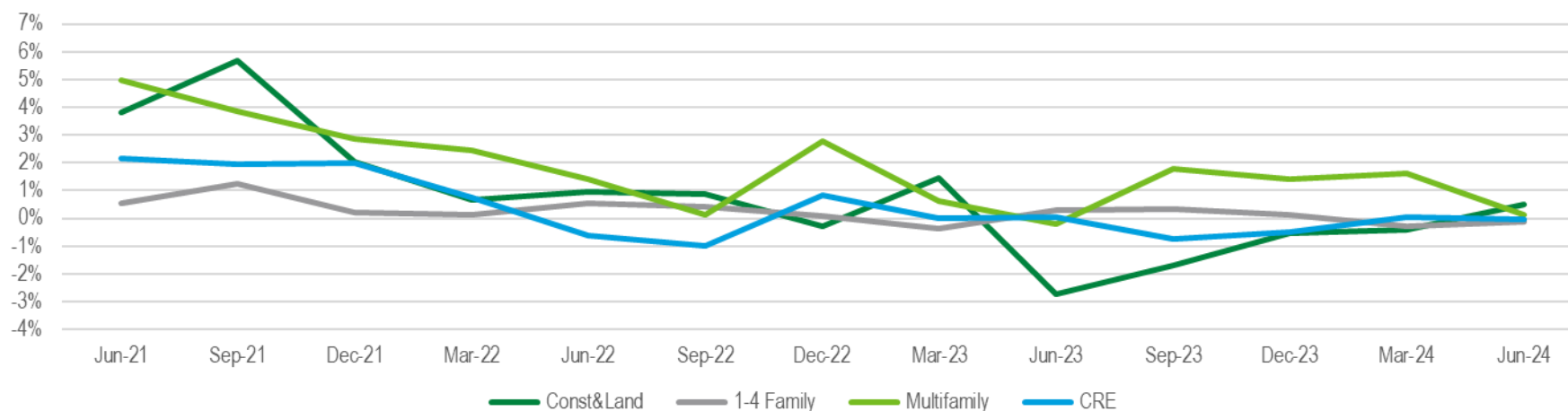
Members are remixing their loan portfolios to help alleviate NIM pressure.



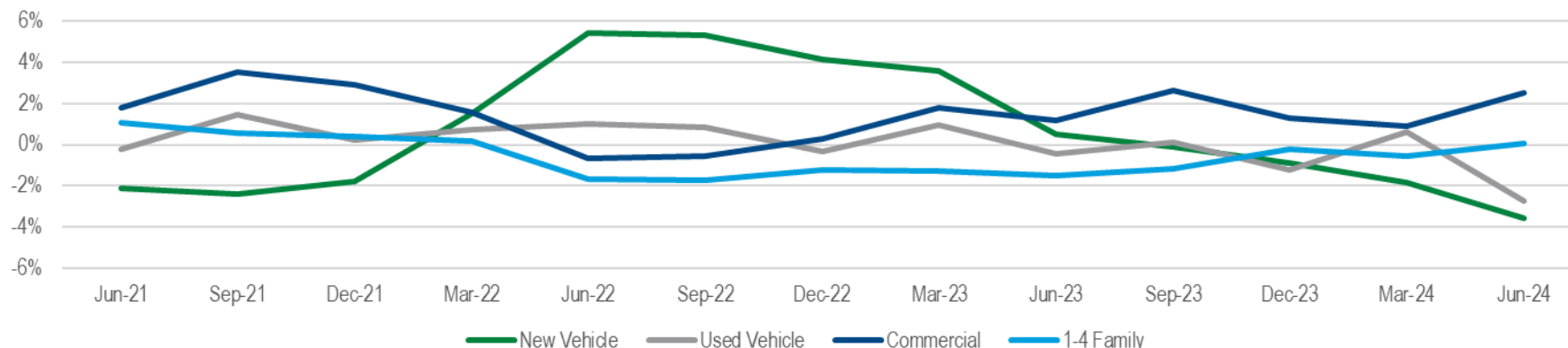
# Loan Growth Rates Indicative of Loan Remix

There is a movement to remix the loan portfolio towards commercial loans due to higher yields. Progress is slow due to the lack of paydowns on current loans, but there is a movement from consumer to commercial loans.

**Bank Loan Type Growth Rates**

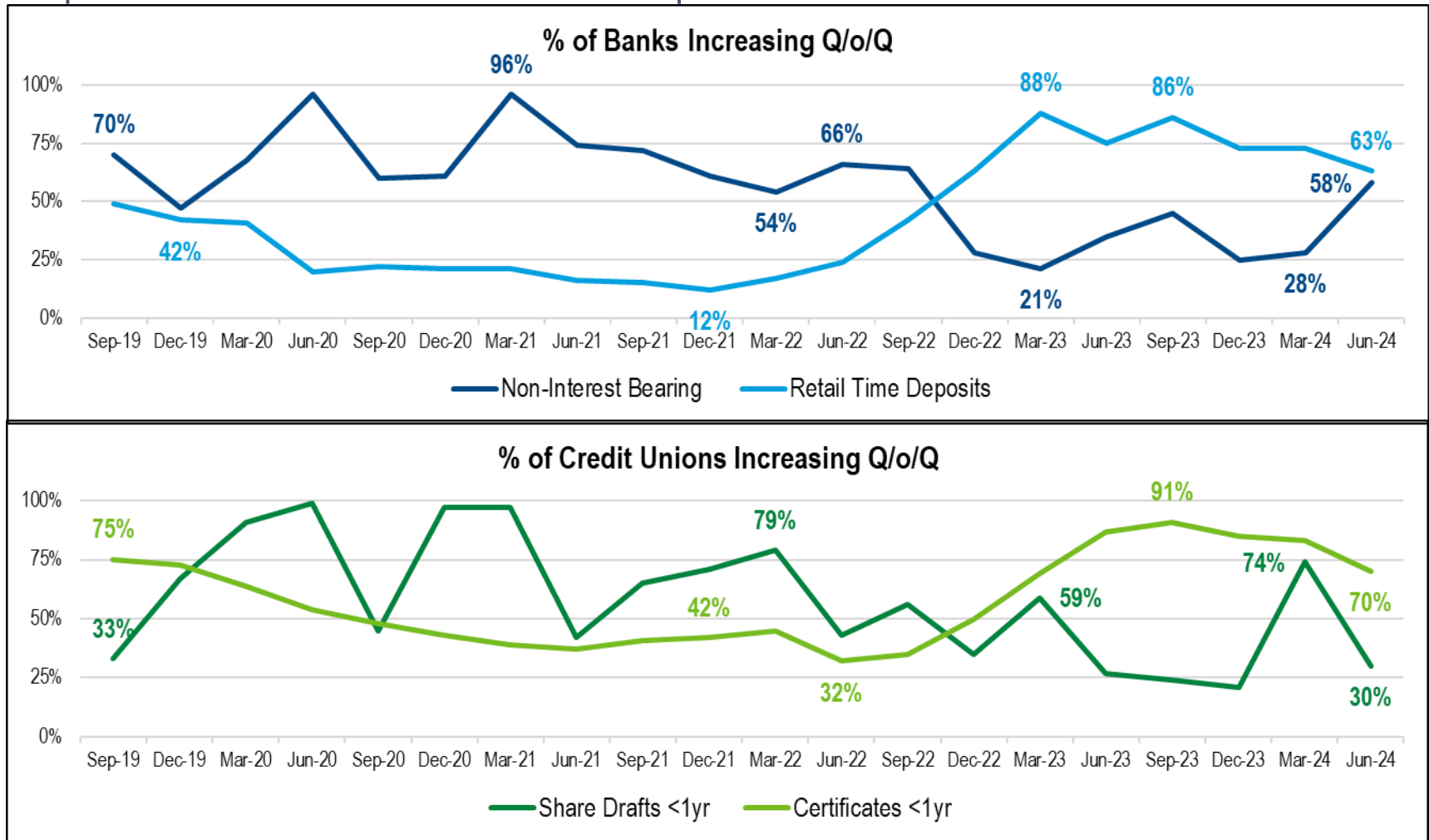


**Credit Union Loan Type Growth Rates**



# Deposit Mix Shift Towards CDs is Moderating

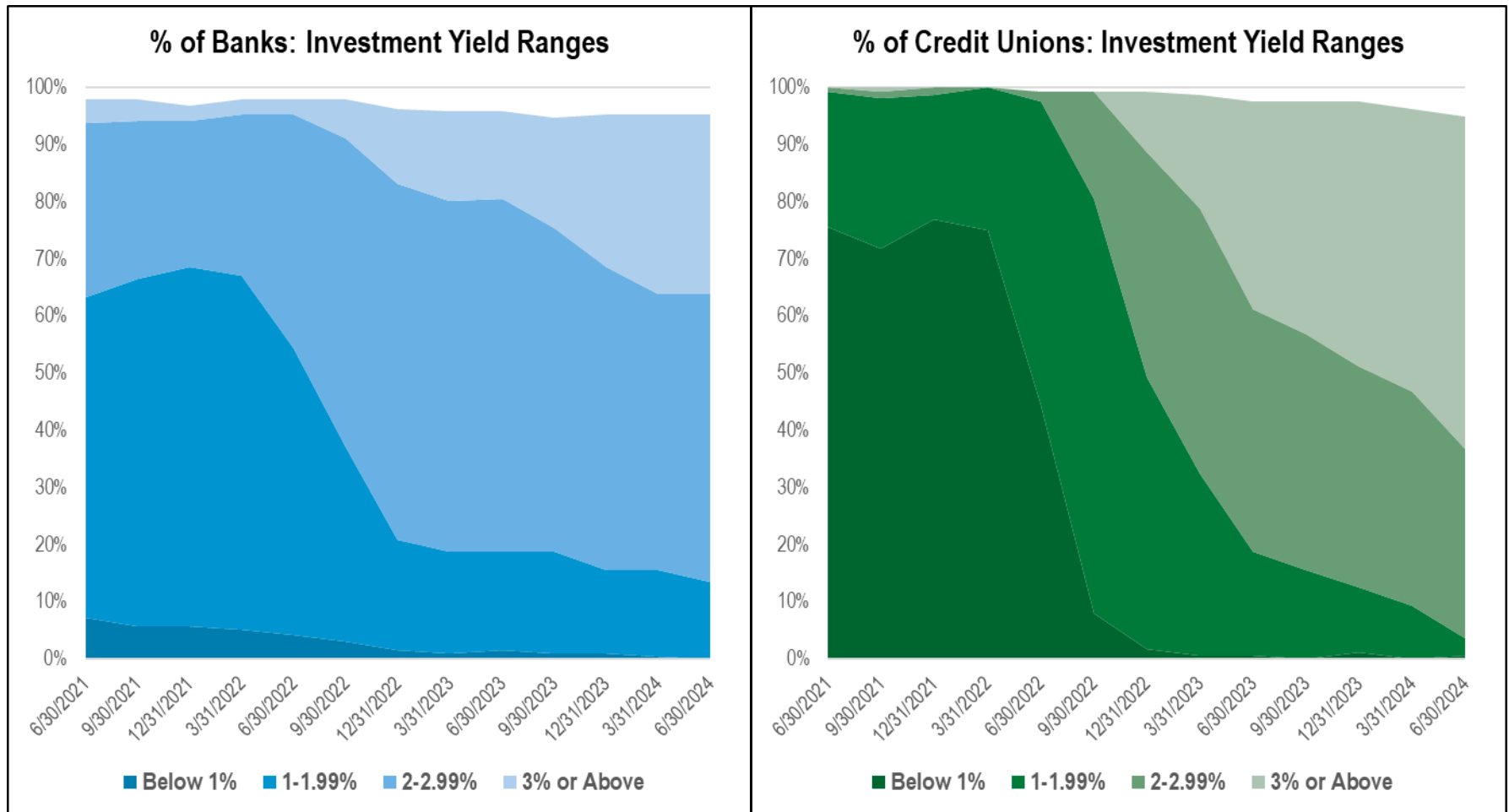
There have been some positive trends in the growth for term and non-maturity deposits that accelerated in the second quarter.





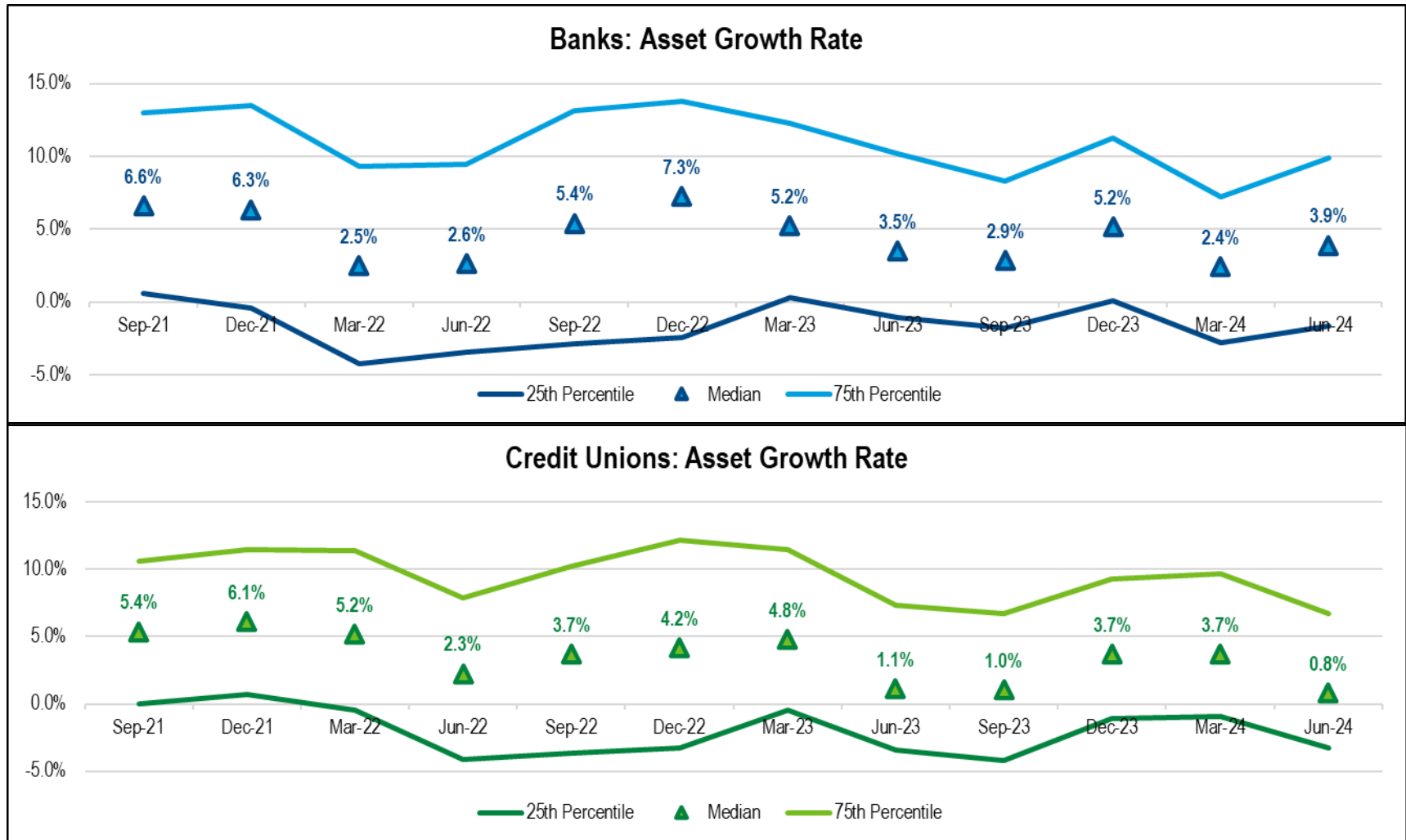
# Investment Yields Rebounding

Investment yields have steadily increased for banks and credit unions as the rate environment improves.



# Total Balance Sheet Growth Trends

Credit unions have tapped the brakes on growth more so than banks.

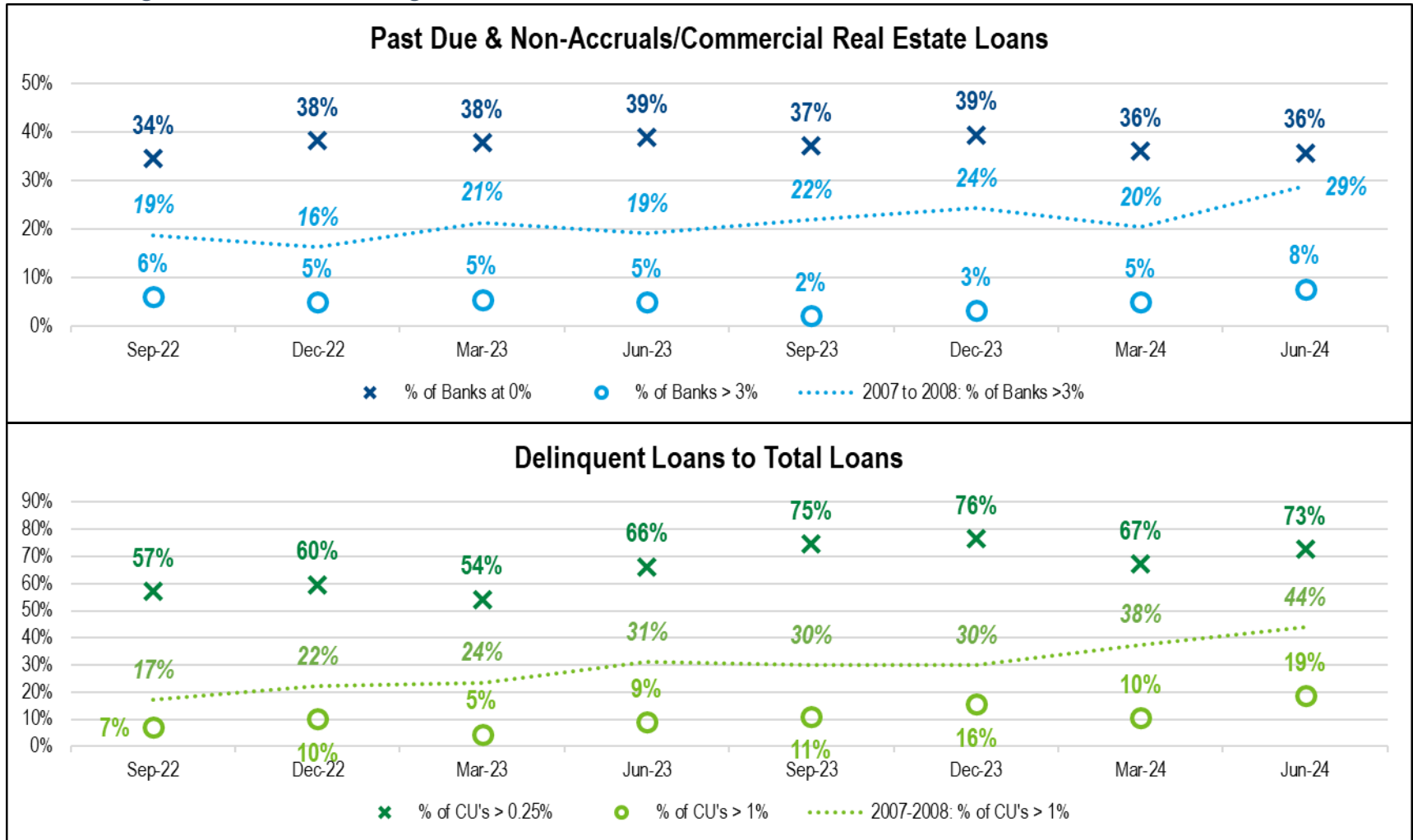


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Source: S&P Global, FHLBank Boston

# Any Signs of Credit Stress Yet?

There were small signs of growing delinquencies from very low levels. Reserve coverage remains strong.



# Balance Sheet Strategies

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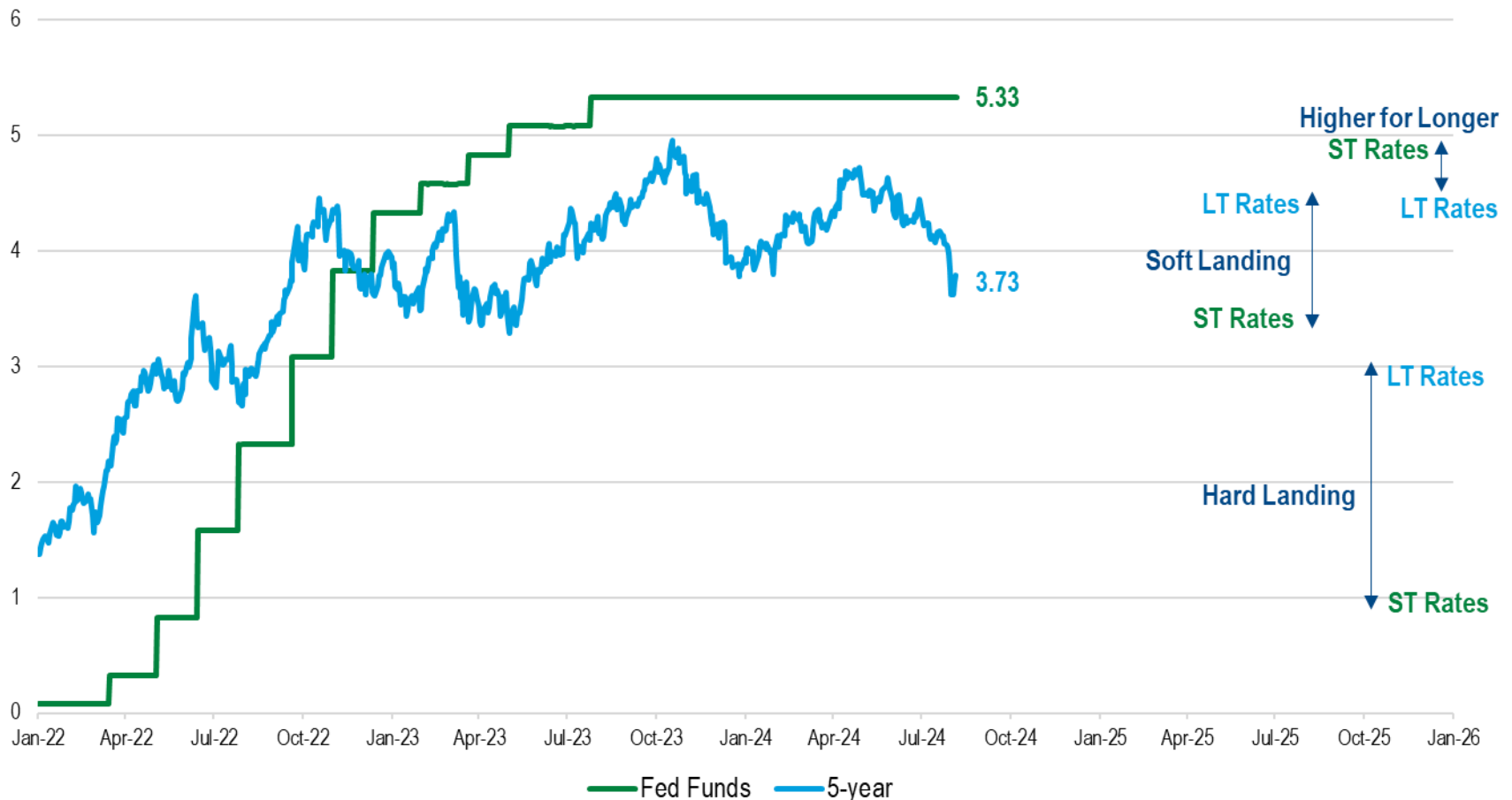
# Balance Sheet Strategies

- What's Next for Rates?
- Lending, Investment & Deposits
- Funding Strategies

# Where Do We Go From Here?

The timing, magnitude and even direction of intermediate rates may be just as or more impactful than the oft-discussed path of short-term rates.

Effective Fed Funds Rate & 5-year Treasury Rate



Source: Federal Reserve Bank of St. Louis, FHLBank Boston

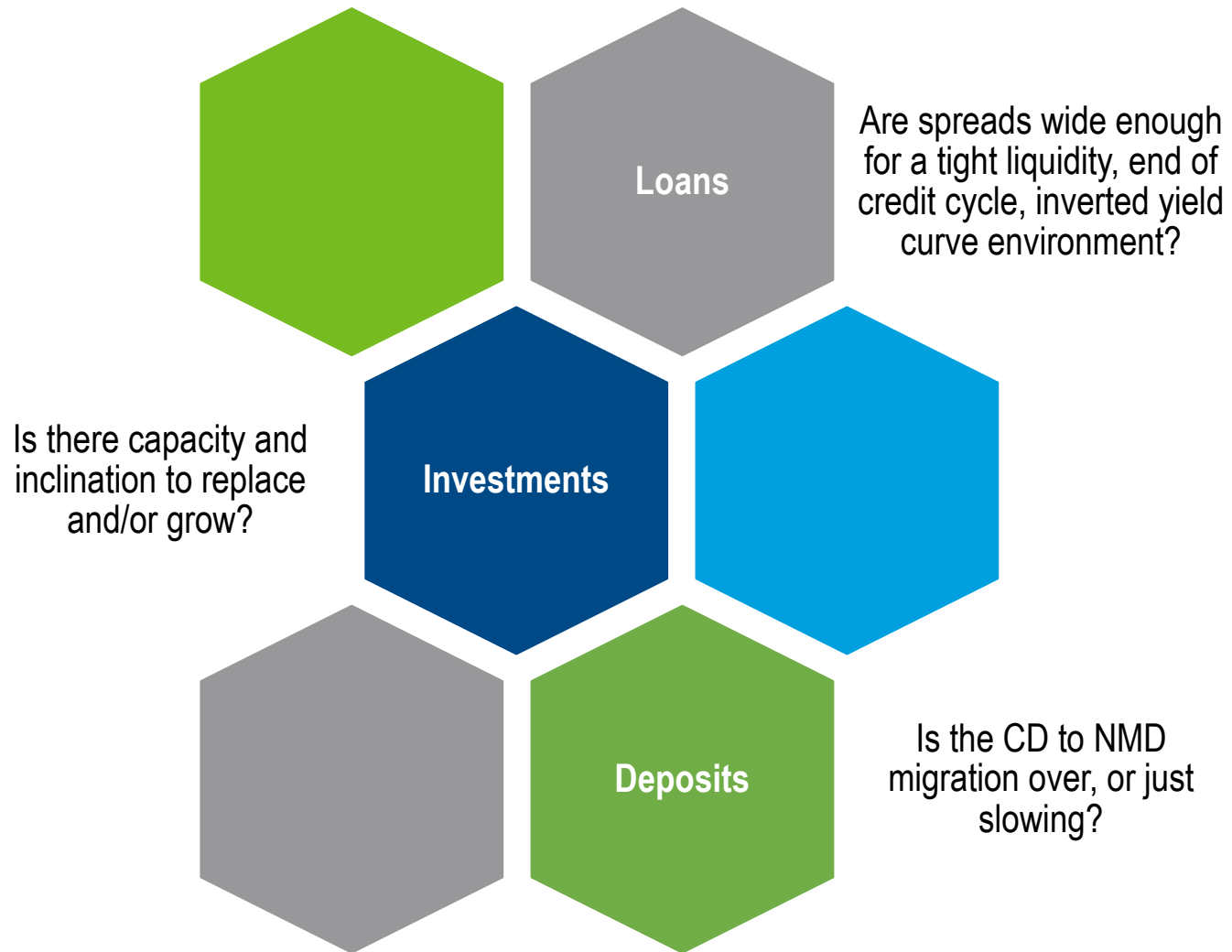
# Preparing for Different Rate Scenarios

What's the balance sheet's pain point, and how does that reconcile with the likelihood that the scenario may play out?

	Soft Landing	Hard Landing	Higher for Longer
<b>Short Rates</b>	Down in line with expectations	Down more than expectations	Down less than expectations
<b>Long Rates</b>	Tough to stay inverted if short rate move is controlled	Room to rally with short rates now lower	Pressure to the upside
<b>Credit/Loan Demand</b>	Not great, not bad	Likely to weaken	Idiosyncratic, potential for pressure from refinancings
<b>Deposit Growth</b>	Not great, not bad	More optimal conditions for inflows	Continued pressure from high rates
<b>Interest-Rate Risk</b>	Gradual shifts over time	Shift towards asset sensitive	Liability sensitivity pressures likely to remain
<b>Liquidity Conditions</b>	Dependent on deposit growth as asset cash flows likely to remain muted	Improved, especially if move in rates is larger enough to see prepay acceleration	Likely to remain pressured, even if growth stalls

# Lending, Investment & Deposit Questions

Balancing today's interest-rate and liquidity risk profile vs. the expected future state.





# Wholesale Funding Strategies

Balancing competing forces of interest-rate risk, liquidity risk and margin pressure.

## Floating-Rate Advances

- Short rates but long liquidity, some with prepay flexibility

## Putable Advances

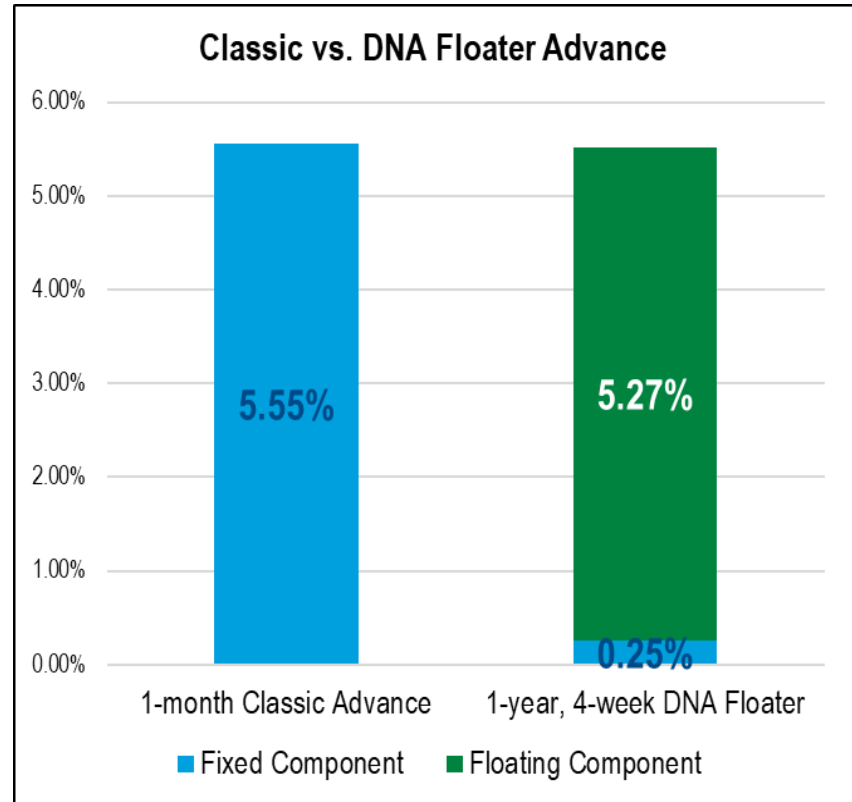
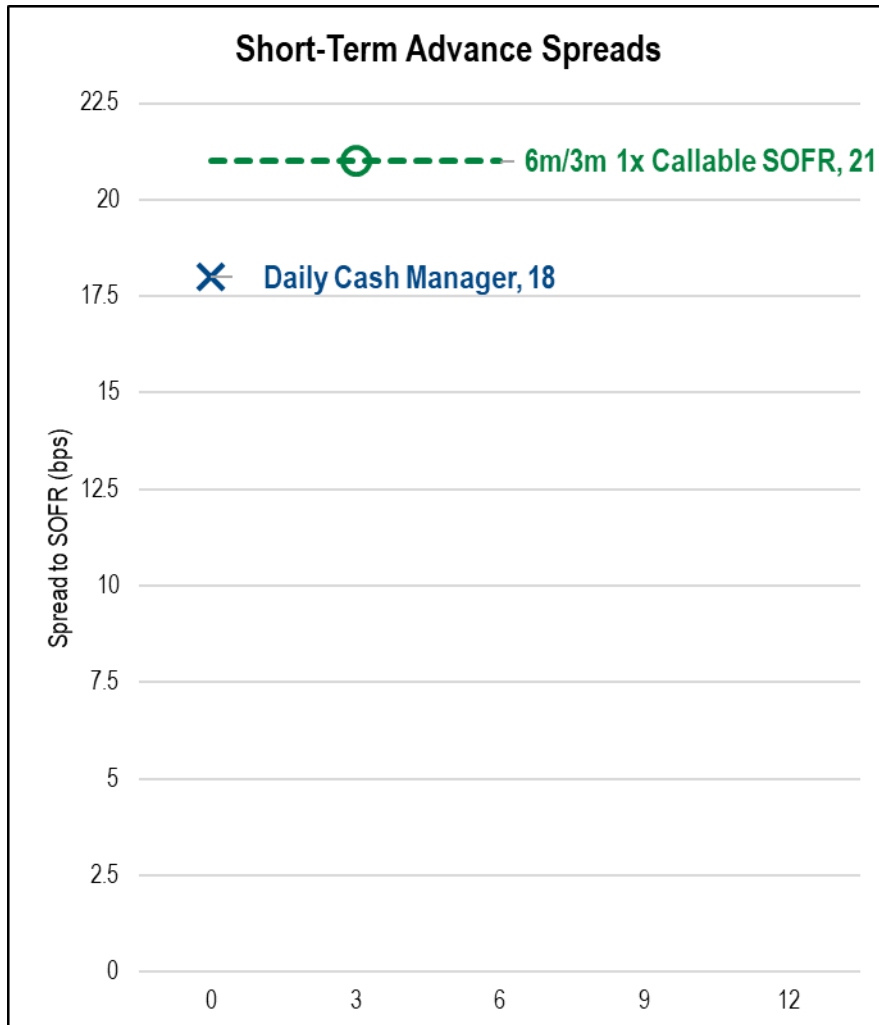
- Interest cost savings with a margin of cushion

## Classic Advances

- Modest extension to fade market rallies

# Floating-Rate Advances

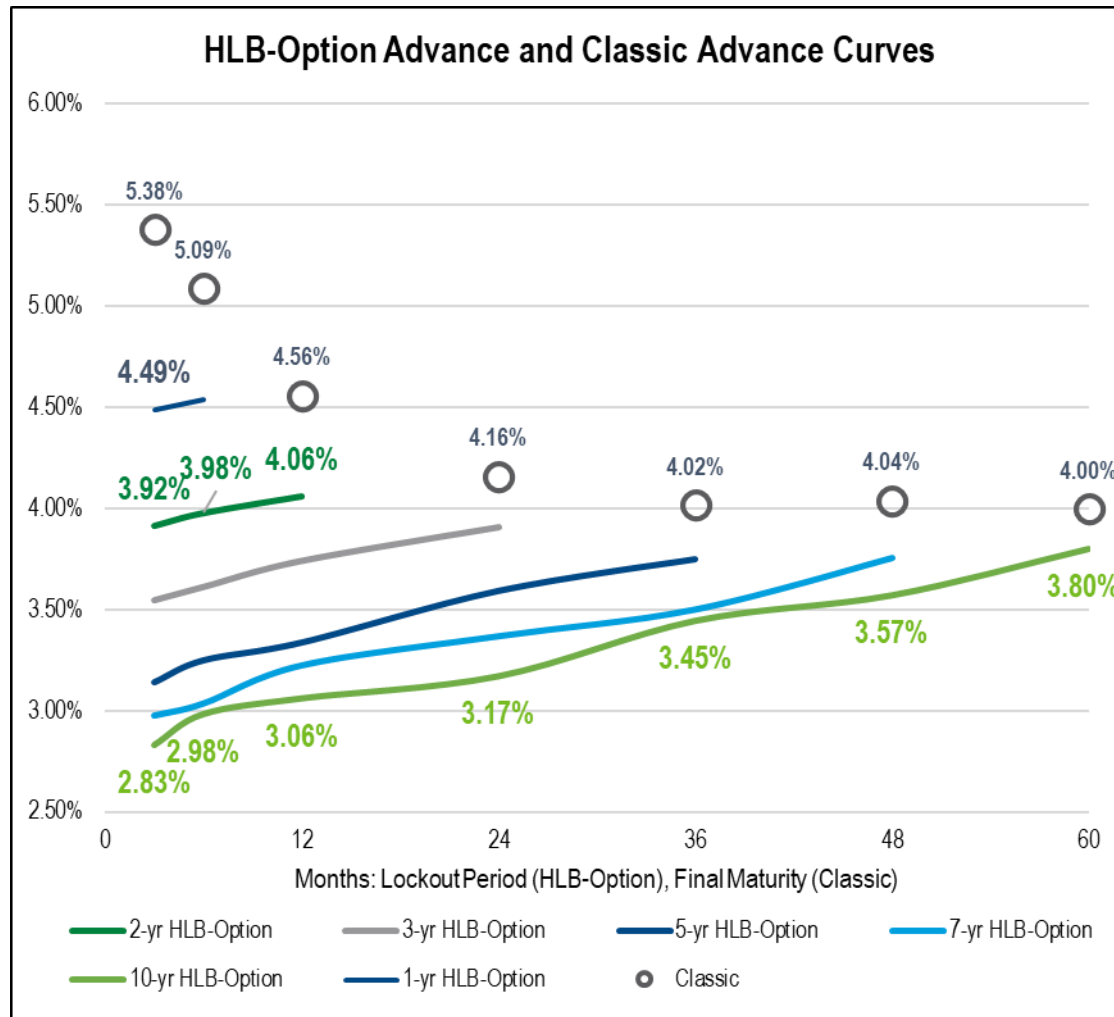
Funding that reprices with market rates, but with term liquidity and prepayment benefits.



DNA Floater vs. Classic Summary	
Cheaper day 1 rate	Same paydown frequency
11 months longer maturity	Less spread risk

# Putable Advances

Volatility remains elevated, with cost savings opportunities immediately and particularly in soft landing scenarios where deposit rates may lag on the way down.



## SOFR Flipper Advance

Like the HLB-Option Advance, with the SOFR Flipper Advance, the member can tailor the maturity, the lockout period and the put frequency

It differs from the fixed-rate HLB-Option in that the SOFR Flipper is a floating-to-fixed advance

Members select the amount of discount (vs. SOFR) for the floating period

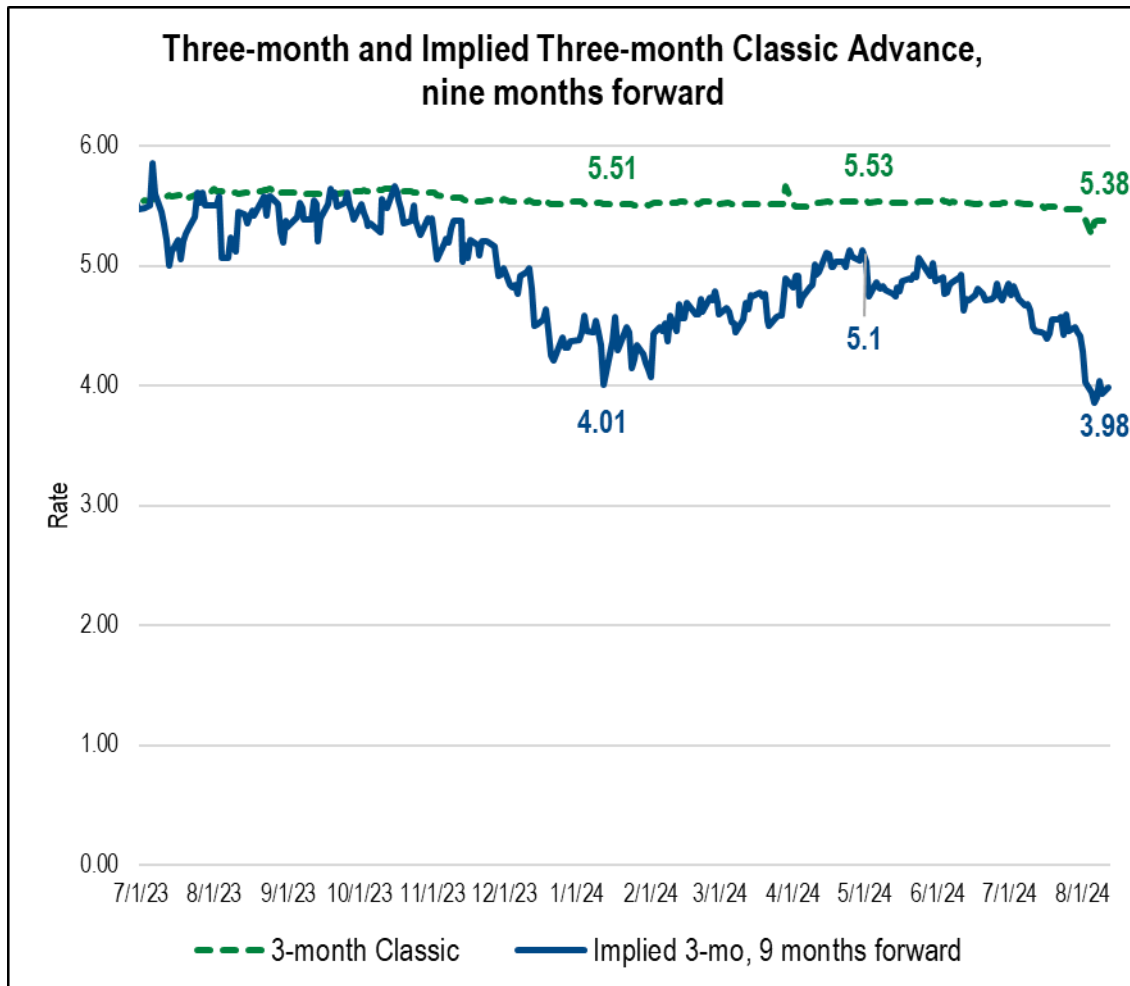
Example #1: 5yr/1yr Qtrly  
SOFR **-100** during the lockout period (day 1 rate of **4.34%**)  
Fixed rate of 3.54% if not put at 1yr mark

Example #1: 5yr/1yr Qtrly  
SOFR **-200** during the lockout period (day 1 rate of **3.34%**)  
Fixed rate of **4.02%** if not put at 1yr mark

Source: FHLBank Boston

# Classic Advances

Fixed rate borrowings offer different ways to hedge interest-rate and liquidity risks.

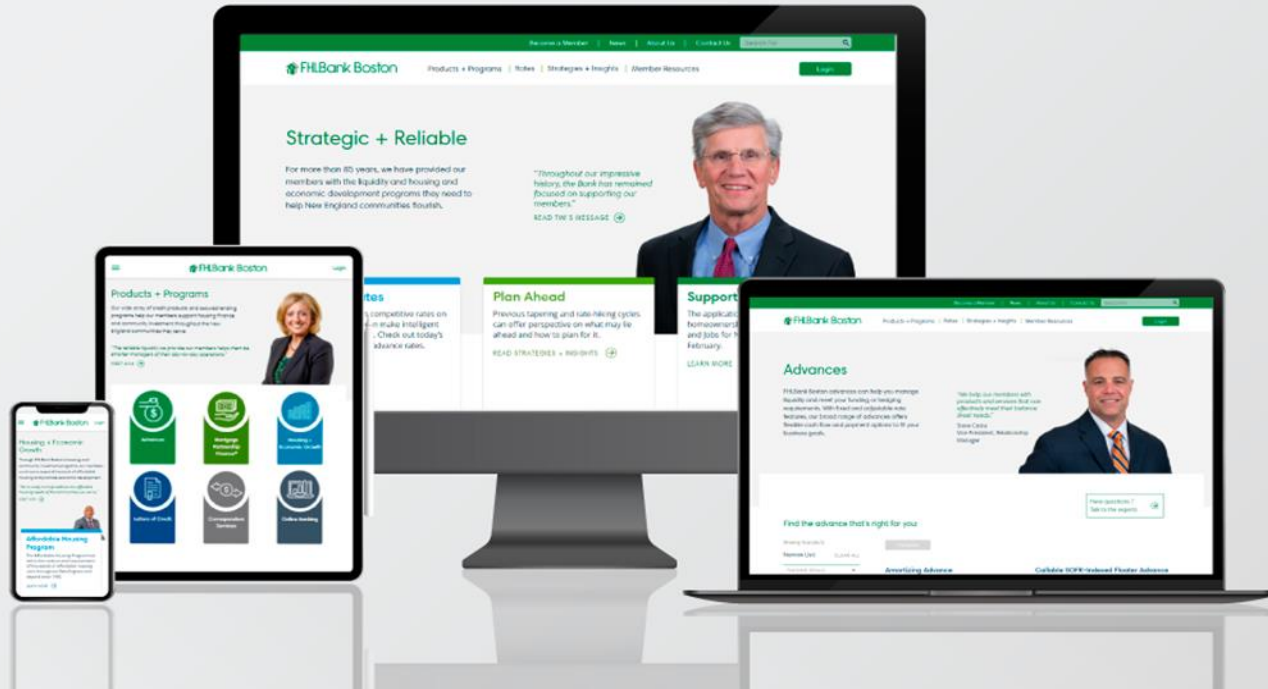


## Fixed-Rate Funding Strategies

**Modest extension** to capture priced-in rate cuts, where wholesale funding need is likely to still be needed

**Forward-starting advances** to “pre-replace” term deposits and/or Bank Term Funding Program

**Advance restructures** to extend liabilities by modifying an existing borrowing, and reducing cost of funds with no adverse current period income statement impact



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# Thank You



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